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No. _____

In The Supreme Court of The United States

PROCESSING SOLUTIONS, LLC, FIRST EAST, INC. AND INSTANT CASH USA, INC.
Petitioners,

v.

AMY LYNN BAILLIE,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF CALIFORNIA

PETITION FOR WRIT OF CERTIORARI

SUSAN VERBONITZ
COUNSEL OF RECORD
MARC J. ZUCKER
WEIR & PARTNERS, LLP
THE WIDENER BUILDING
SUITE 500
1339 CHESTNUT STREET
PHILADELPHIA, PA 19107
215-665-8181
sverbonitz@weirpartners.com

Counsel for Processing Solutions, LLC, First East, Inc. and Instant Cash USA, Inc.

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QUESTION PRESENTED

This case, in which the Court of Appeal of California, First Appellate District, determined that the class arbitration waiver contained in the parties' arbitration agreement was unconscionable under *Discover Bank v. Superior Court*, 36 Cal.4th 148 (2005), presents the following question:

> Whether, under the Federal Arbitration Act, a state court may invalidate an arbitration agreement as being unconscionable because it contains a class arbitration waiver, even though the parties are able to vindicate their rights in arbitration on an individual, and not class, basis.

A similar issue is presently on review before this Court in *AT&T Mobility LLC, v. Concepcion*, 130 S. Ct. 3322 (2010).

PARTIES TO THE PROCEEDING AND RULE 29.6 STATEMENT

Petitioner and defendant/appellant below, Processing Solutions, LLC, is a Delaware limited liability company. Petitioner and defendant/appellant below, First East, Inc., is a Delaware corporation. Petitioner and defendant/appellant below, Instant Cash USA, Inc., is a Nevada corporation.

Pursuant to S. Ct. Rule 29.6, Petitioners state that there is no parent or publicly held company that owns 10% or more of the stock of, and there is no parent company of, Processing Solutions, LLC, First East, Inc. or Instant Cash USA, Inc.

Respondent Amy Lynn Baillie is the plaintiff and was respondent below.

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Petitioners Processing Solutions, LLC ("PSL"), First East, Inc. ("First East") and Instant Cash USA, Inc. ("Instant Cash") (collectively, the "Petitioners") respectfully petition for a writ of certiorari to review the order of the Supreme Court of California, denying review of the order of the Court of Appeal of California, First Appellate District.

OPINIONS BELOW

The order of the Supreme Court of California, denying Petitioners' Petition For Review, is unreported and is reprinted at Pet. App. 1A. The order of the Court of Appeal of California, denying rehearing is unreported and is reprinted at Pet. App. 2A. The opinion of the Court of Appeal of California, entitled *Amy Lynn Baillie v. Processing Solutions, LLC*, is not reported and is reprinted at Pet. App. 3A-28A.

JURISDICTION

The Supreme Court of California denied the Petition for Review on August 11, 2010. Pet. App. 1A. This Court's jurisdiction rests on 28 U.S.C. § 1257.

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Supremacy Clause of the United States Constitution, U.S. Const., Art. VI, cl. 2, provides in pertinent part:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; * * * shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any state to the Contrary notwithstanding.

The Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1, provides in pertinent part:

> No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

Section 2 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 2, provides in pertinent part:

> A written provision in any * * * contract evidencing a transaction involving interstate commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction * * * shall be valid, irrevocable, and enforceable, save upon such grounds as exist in law or equity for the revocation of any contract.

STATEMENT OF THE CASE

LEGAL BASIS

This petition presents an issue which has sharply split multiple state and federal courts, and is presently on review before this Court in *AT&T Mobility LLC, v. Concepcion*, 130 S. Ct. 3322 (2010) ("*AT&T v. Concepcion*"):

> Whether the FAA preempts States from conditioning the enforcement of an arbitration agreement on the availability of class-wide arbitration when those procedures are not necessary to ensure that the parties to the arbitration agreement are able to vindicate their claims? This Court posed the question whether states may impose class procedures in arbitration without answering it in *Southland Corp. v. Keating*, 465 U.S. 1 (1984). This precise question is now before this Court in *AT&T v. Concepcion*.

Section 2 of the FAA mandates that an arbitration agreement is valid, as a matter of federal law, "save upon such grounds as exist at law or in equity for the revocation of any contract." *Perry v. Thomas*, 482 U.S. 483, 492 n.9 (1987). The FAA not only places arbitration agreements on equal footing with other contracts, but also "creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate." *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 625 (1985), quoting *Moses H. Cone*

Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 26 n.32 (1983).

Pursuant to Section 2 of the FAA, this Court has recognized that arbitration agreements may not be enforced based upon "generally applicable contract defenses, such as fraud, duress, or unconscionability." *Rent-A-Center, West, Inc. v. Jackson*, 130 S. Ct. 2772, 2776 (2010) (quoting *Doctor's Associates, Inc. v. Casarotto*, 517 U.S. 681, 687 (1996)).

Under California law, a court may refuse to enforce a contract that is found to have been unconscionable at the time it was made. Courts also can sever or limit any unconscionable clause in order "to avoid any unconscionable result." Cal.C.C. § 1670.5(a).

A party claiming unconscionability has the burden of showing both procedural and substantive unconscionability to nullify a contract. *Gatton v. T-Mobile USA, Inc.*, 152 Cal.App.4th 571, 579 (2007); *Armendariz v. Foundation Health Psychcare Services, Inc.*, 24 Cal.4th 83, 112 (2000). The procedural element concerns the manner in which the contract was negotiated and focuses on "oppression" or "surprise." *Id.* at 114. The substantive element focuses on the terms of the contract and evaluates whether they create "overly harsh" or "one-sided results." *Wayne v. Staples, Inc.*, 135 Cal.App.4th 466, 480 (2006); *Discover Bank*, 36 Cal.4th 148, 160 (2006) ("*Discover Bank*").

California's "sliding scale" approach to unconscionability provides that procedural and substantive unconscionability need not be present to the same degree. "The more substantively oppressive the contract term, the less evidenced of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and visa versa." *Armendariz*, 24 Cal.4th at 114.

In cases where the arbitration agreement provides for the resolution of disputes on an individual basis, *i.e.*, where the arbitration clause contains a class arbitration waiver, California has adopted a three-prong test to determine unconscionability. Under that test, an arbitration agreement is deemed to be unconscionable and unenforceable if it:

> [(1)] is found in a consumer contract of adhesion [(2)] in a setting in which disputes between the contracting parties predictably involve small amounts of damages, and [(3)] when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money.

Discover Bank, 36 Cal.4th at 162-163.

While generally applicable contract defenses can justify refusal to enforce an arbitration

agreement in proper circumstances, this Court has never suggested, as proclaimed by the courts in California, that an arbitration provision may be held invalid based upon a state policy that does not apply to all contracts, but only to a certain variety of arbitration agreements where small dollar consumer claims are involved and in which the parties agreed that their arbitration would be on an individual and not a class basis. Yet the Court of Appeal's decision in this case relied upon *Discover Bank's* three-prong test in invalidating the arbitration clause at issue because it provided for individual, and not class, arbitration.

The focus of California courts upon the presence of class waivers in arbitration provisions as proof of substantive unconscionability is in direct conflict with the central purpose of the FAA to enforce arbitration agreements according to their terms. The conflict between California law and that of other states has nationwide implications as it affects virtually every standard consumer contract which contains an arbitration provision, providing for arbitration on an individual, not a class basis.

Around the country courts enforce arbitration agreements as written as this Court has directed, declining to rewrite the parties' contract either to exclude a class waiver to which the contracting parties freely agreed, or to include class procedures in arbitration to which the parties did not agree. Under California's rule, parties to standard consumer contracts containing standard arbitration

provisions conceivably face starkly different proceedings arising from those contracts -- depending on whether they choose to sue or are sued in California or elsewhere.

The question left open in *Southland Corp.*, whether the California Supreme Court's ruling imposing a class action structure on arbitration conflicts with the FAA, still vexes the nation's courts and is squarely presented by this case. The conflict between the California court's approach and that of the overwhelming majority of federal and state courts of appeal has only deepened over the years, as is evidenced by the issue before this Court in *AT&T v. Concepcion*. Pending this Court's decision in that case, California and other courts will continue to invalidate agreements to arbitrate disputes not because they preclude parties from vindicating their rights and pursuing claims, however small, in arbitration, but because they preclude them from doing so on a class basis. Accordingly, review of this case by this Court is warranted on the same grounds as presented in *AT&T v. Concepcion*.

FACTUAL BACKGROUND

A. Baillie's Loan And Agreement To Arbitrate All Disputes.

In early July, 2006, Amy Lynn Baillie ("Baillie") sought out a loan over the Internet. She submitted an online application for a short term loan in the amount of $300 from MTE Financial Services,

Inc. ("MTE"), a tribal entity formed by the Modoc Tribe of Oklahoma, a federally-recognized tribe. PSL assisted MTE in marketing its loans and processing its loan applications, which were submitted by applicants over the Internet.

Baillie's loan application was approved, and she received a $300 loan from MTE. The loan proceeds were deposited directly into Baillie's checking account at her bank via an ACH credit entry transaction. According to Baillie, her bank account was debited at various times for the fees charged for the loan and/or subsequent refinancing of the loan.

Baillie's loan is evidenced by a Note and Disclosure Statement ("Note") dated July 2, 2006 which was electronically transmitted to Baillie over the Internet. The Note clearly identifies MTE as the lender.[1]

The Note contains the following binding arbitration agreement which covers all claims and disputes between the parties, including disputes relating to the arbitration agreement:

> [Y]ou and we agree that any and all claims, disputes or controversies that

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[1] Baillie alleges that PSL, First East, and Instant Cash are wholly owned subsidiaries, sister corporations, or fictitious names for MTE and defines "Defendant Lenders" to include not only MTE, but also the Petitioners and other named defendants.

> we or our servicers or agents have against you or you have against us, our servicers, agents, directors, officers and employees, that arise out of your application for one or more loans, the Loan Agreements that govern your repayment obligations, the loan for which you are applying or any other loan we previously made or later make to you, this Agreement to Arbitrate All Disputes, collection of the loan or loans ... including disputes as to the matters subject to arbitration, shall be resolved by binding individual (and not class) arbitration by and under the Code of Procedure of the National Arbitration Forum ('NAF') in effect at the time the claim is filed. . . .

The arbitration clause provides that the cost of a participatory hearing for claims of $15,000 or less (such as Baillie's claim), would be paid by MTE. To reduce any expense to Baillie associated with arbitration, the arbitration clause also provides that a participatory hearing would take place at a location near Baillie's residence.

The Note contains a governing law clause, providing that federal law and the laws of the jurisdiction where MTE (the lender) is located govern the transaction, and that, for issues not decided by an arbitrator, the latter jurisdiction has "exclusive" authority over all matters related to the

Note, "forsaking any other jurisdiction which either party may claim by virtue of its residency."

Baillie signed the Note electronically by typing her name into the electronic signature field, and typing "I AGREE" next to her signature.

B. Proceedings And Review In The California State Courts

Although Baillie agreed to arbitrate disputes, she filed a putative class action in California state court on May 22, 2007. Her initial complaint was against other entities from whom she alleged she obtained her loan. Baillie then amended her complaint to include a collection company and a ".com." On August 13, 2007, Baillie filed a second amended complaint and, for the first time, named MTE, PSL, First East and Instant Cash.

PSL, First East and Instant Cash responded to Baillie's complaint by moving to stay the proceedings pending arbitration of Baillie's claims, and demurred to the complaint. In their motion, Petitioners argued that the FAA governed the enforcement of the arbitration agreement. Baillie did not dispute that she freely agreed to arbitrate her disputes and that the arbitration agreement was governed by the FAA. Rather, Baillie opposed the stay motion, contending principally that the arbitration provision was unconscionable under California law because it required arbitration on an individual, and not class, basis.

On April 10, 2009, the trial court denied the motion to stay, ruling that the arbitration clause was procedurally and substantively unconscionable. Pet. App. 29A-35A. The trial court recognized that MTE made the loan. Pet. App. 30A. The trial court found that the arbitration agreement is governed by the FAA. Pet. App. 32A. Nevertheless, the trial court applied California law to determine the issue of unconscionability, even though the Note provided that federal law and the law of the lender's jurisdiction apply. *Id.*

The trial court found the arbitration agreement unenforceable. It ruled that the agreement had "limited aspects of procedural unconscionability," characterizing the underlying Note as a contract of adhesion. Pet. App. 33A. The trial court also held that the arbitration agreement was substantively unconscionable partly because it "prohibits class arbitration." Pet. App. 34A. The trial court based its ruling on the assumptions that the claims would tend to be modest in amount and the time and expense of arbitration would deter individual claims. *Id.* The trial court applied a "sliding scale" approach to find the arbitration agreement unenforceable. Pet. App. 35A.

The Court of Appeal affirmed the trial court's decision, but for slightly different reasons. It held that the class waiver had "all the hallmarks of unconscionability" under the California Supreme Court's three-prong *Discover Bank* test because (1) the class action waiver was included in an

arbitration agreement that was embedded in a contract of adhesion; (2) the case involved a "modest sum"; and (3) Baillie alleged that the defendants "targeted the poorest and most vulnerable members of society" and "profited illegally" at their expense. Pet. App. 19A, 22A. The Court of Appeal rejected the rule of *Gentry v. Superior Court*, 42 Cal.4th 443 (2007), stating that the *Discover Bank* analysis applies to invalidate a class action waiver on grounds of unconscionability when contained in a consumer contract. Pet. App. 22A.

The Court of Appeal's application of the *Discover Bank* test rejected as irrelevant the issue of whether the parties could effectively vindicate their rights in arbitration. Instead, the enforcement of an arbitration agreement was, according to the Court of Appeal, conditioned on the absence of a form contract and allegations that the claim was for a small amount and that the defendants engaged in a scheme to deliberately cheat consumers out of small amounts of money. Pet. App. 20A, 22A.

The Court of Appeal did not address Petitoners' argument that enforcement of the arbitration clause under the FAA was a matter of federal substantive law. It rejected the argument that the issue of unconscionability should be decided by the arbitrator under the holding of *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995), Pet. App. 11A, and declared that the language of the delegation provision did not "clearly and unmistakably" provide that matters of contract

formation would be decided by the arbitrator. Pet. App. 12A.

The Court of Appeal also rejected the argument that the class waiver could be severed and the arbitration clause enforced, holding that the arbitration agreement was "tainted with illegality" and, therefore, severance of the class waiver was inappropriate. Pet. App. 25A.

On June 11, 2010, Petitioners filed a Petition for Rehearing in the Court of Appeal. Petitioners argued that the method by which the parties agree to conduct their arbitration does not somehow permeate the agreement with illegality because, under the FAA, parties are free to specify by contract how their arbitration is to be conducted. By Order dated June 22, 2010, the Court of Appeal denied the Petition for Rehearing. Pet. App. 2A.

On July 6, 2010, Petitioners filed a Petition for Review to the Supreme Court of California. Although the Supreme Court of California had addressed the preemption issue in *Discover Bank*, Petitioners requested that the Court grant review on the issue whether the FAA preempts the rule under California law that a class action waiver contained in a consumer arbitration agreement is unconscionable and, therefore, unenforceable. The question is fundamental to the enforcement of the arbitration agreement and of particular importance in light of *AT&T v. Concepcion*. For this reason, Petitioners requested that the Supreme Court of California hold review pending this Court's decision in *AT&T v.*

Concepcion. The Supreme Court of California denied the Petition for Review on August 11, 2010. Pet. App. 1A.

REASONS FOR GRANTING THE WRIT OF CERTIORARI

I. THE COURT SHOULD GRANT CERTIORARI IN THIS CASE PENDING A DECISION IN *AT&T v. CONCEPCION* AS TO WHETHER THE FAA PREEMPTS STATE RULES REQUIRING CLASS ACTION PROCEDURES TO BE SUPERIMPOSED ON ARBITRATION.

Long before the state and federal conflicts over the enforceability of arbitration agreements reached as far and wide as they do today, this Court ordered briefing and argument on the question whether, "if state law required" "superimposing class-action procedures on a contract arbitration," "it would conflict with the [FAA] and thus violate the Supremacy Clause." *Southland*, 465 U.S. at 8. In 1987, this Court concluded that it lacked jurisdiction to decide the issue. Today the question is neither rhetorical nor hypothetical. The present case focuses on a long-simmering and extraordinarily important issue that has created conflict among the states and the federal circuits, and is now before this Court in *AT&T v. Concepcion*. This issue is of such great importance not only to AT&T and the Petitioners, but to all businesses whose interaction with California consumers may possibly expose them to

California's rule subjecting consumer arbitration agreements to special scrutiny.

A. The California Court's Ruling Conflicts With The Decisions Of Multiple Other Federal And State Courts.

State courts around the country have upheld arbitration agreements containing class action waivers. The Tennessee Court of Appeals held that, regardless of any state-law concern about "the unavailability of class action relief," "the Supremacy Clause of the Federal Constitution. . . preclude[s] [a court] from invalidating an arbitration agreement otherwise enforceable under the FAA simply because a plaintiff cannot maintain a class action." *Pyburn v. Bill Heard Chevrolet*, 63 S.W.3d 351, 365 (Tenn. Ct. App. 2001).[2]

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[2] The Tennessee Supreme Court denied the plaintiff's petition for review in that case and ordered the state court of appeals decision published (63 S.W.3d at 351), which means that the decision "may be relied upon by the bench and bar of [Tennessee] as representing the present state of the law with the same confidence and reliability as the published opinions of [the Tennessee Supreme] Court." *Meadows v. State*, 849 S.W.2d 748, 752 (Tenn. 1993).

State courts in Texas[3] and Illinois[4] have adopted the same reasoning and declined to invalidate class waivers in arbitration agreements. Courts in Delaware, the District of Columbia, Kansas, Maine, Maryland, and North Dakota also have determined that class action waivers are not unconscionable under state law.[5]

Other courts, such as the Supreme Courts in Alabama, Illinois, and West Virginia, have found arbitration clauses containing class action waivers invalid only where the arbitration clause contained other unfair provisions, such as limitations on claims, causes of action, or punitive damages.[6]

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[3] *AutoNation USA Corp. v. Leroy*, 105 S.W.3d 190 (Tex. App. 2003) (right to arbitrate under the FAA trumps right to maintain a class action).

[4] *Hutcherson v. Sears Roebuck & Co.*, 342 Ill.App.3d 109, 793 N.E.2d 886 (2003)(class action waiver is not unconscionable under Arizona law and FAA requires class action waiver to be enforced in accordance with its terms).

[5] *See Strand v. U.S. Bank Nat'l Ass'n* , 2005 ND 68, 693 N.W.2d 918, 926 (2005); *Walther v. Sovereign Bank*, 386 Md. 412, 438-42, 872 A.2d 735, 750-53 (2005); *Stenzel v. Dell, Inc.*, 870 A.2d 133 (Me. 2005); *Forrest v. Verizon Communications, Inc.*, 805 A.2d 1007 (D.C. App. 2002)(upholding validity of forum selection clause despite unavailability of class actions in that forum); *Pick v. Discover Financial Services, Inc.*, 2001 WL 1180278 (D. Del. 2001).

[6] *See Leonard v. Terminix Int'l Co.*, 854 So.2d 529, 538-39 (Ala.2002) (striking clause that also limited damages); *Kinkel v. Cingular Wireless LLC*, 223 Ill.2d 1, 857 N.E.2d 250, 306 Ill.Dec. 157 (2006) (clause did not provide for recovery of

Appellate courts in Florida, Missouri, and Pennsylvania invalidated arbitration agreements only where the class waiver was accompanied by unfair limits on claims and damages.[7]

Originally aligned with only a few other state courts,[8] California has determined that an otherwise valid arbitration agreement which contains a class action waiver is unconscionable as to small consumer

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attorney's fees if permitted by applicable law and limited punitive damages); *State ex rel. Dunlap v. Berger*, 211 W.Va. 549, 567 S.E.2d 265 (2002) (prohibiting punitive damages), *cert. denied, sub nom., Friedman's, Inc. v. West Virginia ex rel. Dunlap*, 537 U.S. 1087 (2002).

[7] *Powertel, Inc. v. Bexley*, 743 So.2d 570, 575-76 (Fla. 1st DCA 1999), review denied, 763 So.2d 1044 (Fla. 2000) (company's liability limited only to actual damages, no provision allowing injunctive or declaratory relief as provided for in state statute); *Bellsouth Mobility LLC v. Christopher*, 819 So.2d 171, 173 (Fla. 4th DCA 2002) (same); *Whitney v. Alltel Communications, Inc.*, 173 S.W.3d 300, 313-14 (Mo. App. 2005) (arbitration agreement required consumer to bear own costs, making it prohibitively expensive); *Thibodeau v. Comcast Corp.*, 912 A.2d 874 (Pa. Super. 2006) (clause effectively forced consumer to arbitrate but left access to court open to company).

[8] The Supreme Courts of New Mexico and New Jersey join California, choosing to treat arbitration agreements in "low value" cases differently from other contracts. *Fiser v. Dell Computer Corp.*, 2008-NMSC-046, 144 N.M. 464, 188 P.3d 1215 (2008); *Muhammad v. County Bank of Rehoboth Beach, Delaware*, 189 N.J. 1 (2006). While the latter court severed the class waiver and enforced the arbitration agreement, the former did not.

claims. *Discover Bank, supra.* The California rule, however, now threatens to become the *de facto* nationwide rule for invalidating arbitration agreements, regardless of whether they contain class waivers or not. Already, other state courts have invalidated the parties' agreements to arbitrate individually, rather than as a class, in an effort to promote state public policies favoring class actions.[9]

Most federal courts of appeals have rejected state courts' holdings that arbitration provisions containing class waivers are unconscionable even when the damages sought are small, finding those holdings to be preempted by the FAA. *Schultz v. AT&T Wireless Servs., Inc.*, 376 F. Supp. 2d 685, 691 (N.D. W.Va. 2005). The Third Circuit, in *Gay v. CreditInform*, 511 F.3d 369, 392-394 (3d Cir. 2007), held that the FAA preempts Pennsylvania's rule that class action waivers are unconscionable.[10] The

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[9] *See Ruhl v. Lee's Summit Honda*, 2010 WL 3441256 (Mo. August 31, 2010) (provision waving class arbitration was unconscionable); *Feeney v. Dell, Inc.*, 908 N.E.2d 753 (Mass. 2009) (provision for arbitration of individual claims violated Massachusetts' public policy); *Scott v. Cingular Wireless*, 160 Wash.2d 843, 161 P.3d 1000 (2007) (holding a waiver of class action arbitration violated Washington public policy and was substantively unconscionable).

[10] In *Homa v. American Express Co.*, 558 F.3d 225, 230 (3d Cir. 2009), the Court distinguished *Gay* on the ground that Pennsylvania law is limited to arbitration clauses in violation of Section 2 of the FAA, and held that the FAA does not preempt New Jersey law because it applies to both arbitration provisions as well as other contract.

Fourth, Sixth, Seventh, and Eighth Circuits have found that the procedural right to a class action is waivable and that an arbitration clause containing a class action waiver is fully enforceable. [11]

In contrast, the Ninth Circuit, on review by this Court, has held that AT&T's arbitration agreement was unconscionable under California's *Discover Bank* test because it required consumers to arbitrate small claims on an individual basis. *Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009).

As reflected by the holding in this case, pending a decision by this Court in *AT&T v. Concepcion*, the California courts and other state and federal courts will continue to single out those arbitration agreements based upon public policy concerns that do not apply to other contracts. Entities providing various goods and services to consumers who agree to arbitrate their claims will be forced into litigation simply because the courts may decide that the claims stemming from their contracts are "modest" enough to render their arbitration agreements unconscionable. In California at least,

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[11] *Snowden v. CheckPoint Check Cashing*, 290 F.3d 631, 638 (4th Cir. 2002); *Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001); *Caudle v. American Arbitration Ass'n*, 230 F.3d 420 (7th Cir. 2000); *Livingston v. Associates Fin., Inc.*, 339 F.3d 814 (7th Cir. 2003); *In re Piper Funds, Inc.*, 71 F.3d 298 (8th Cir. 1995); *Randolph v. Green Tree Fin. Corp. – Alabama*, 244 F.3d 814 (11th Cir. 2001) *on remand from Green Tree Fin. Corp. – Alabama v. Randolph*, 531 U.S. 79 (2000).

the validity of these contracts will not depend upon the intent of the parties to the contract, but on what the party opposing arbitration alleges in the lawsuit.

B. The FAA Preempts California's Rule That Class Action Waivers Are Unconscionable Where The Claims Involve A "Modest" Amount And The Party Opposing Arbitration Alleges Fraudulent Conduct.

The FAA "declared a national policy favoring arbitration and withdrew the power of the state to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland*, 465 U.S. at 10. "[M]otivated, first and foremost, by a congressional desire to enforce agreements into which parties had entered," the FAA was passed to "ensure judicial enforcement of privately made agreements to arbitrate," placing arbitration agreements "upon the same footing as other contracts." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 219, 220 (1985); *see Mastrobuono v. Shearson Lehman Hutton, Inc.*, 514 U.S. 52 (1995) (Arbitration Act's "central purpose" is "to ensure 'that private agreements are enforced according to their terms'") (quoting *Volt Info. Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 479 (1989)).

While unconscionability is a contract defense, the preemptive federal law would preclude California courts and elsewhere from invoking a public policy rule that class action waivers in arbitration

provisions are unconscionable. This Court has rejected the narrow interpretation of this defense to invalidate arbitration agreements, explaining that the FAA precludes state courts from "rely[ing] on the uniqueness of an agreement to arbitrate as a basis for a state-law holding that enforcement would be unconscionable." *Perry*, 482 U.S. at 492, n.9. *See also, Buckeye Check Cashing v. Cardegna*, 546 U.S. 440, 446 (2006) (under the FAA "the enforceability of [an] arbitration agreement [cannot] turn[] on the state's legislative judgment concerning the forum.") While the defense of unconscionability may apply to any contract, § 2 of the FAA permits the invalidation of agreements to arbitrate only "upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Under the Supremacy Clause, state laws in conflict with the FAA's strong policy in favor of arbitration must give way. *See, e.g., Perry*, 482 U.S. at 483 (finding preempted a California law allowing certain actions to be maintained in court "'without regard to the existence of any private agreement to arbitrate'") (quoting Cal. Lab. Code Ann. § 229).

California has no generally applicable prohibition against contractual waivers of class actions. There is no statute or rule which states that all contractual class waivers are unenforceable. Yet California's *Discover Bank* rule conditions enforcement of arbitration clauses on the absence of a class waiver and the amount of the claim, and turns on whether fraudulent conduct is alleged by the party opposing arbitration. That rule bears no

resemblance to the defense of unconscionability. In applying the *Discover Bank* rule in this case, the California court used the unconscionability doctrine in a way that is not applied to "any contract."

Moreover, the enforceability of an arbitration agreement does not and cannot depend upon the amount of the claims and the particular allegations made by the plaintiff in the lawsuit. To subject arbitration agreements to such a standard which is not generally applicable to other types of contracts further violates the FAA. "[S]tate law, whether of legislative or judicial origin, is applicable *if* that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally." *Perry*, 482 U.S. at 492 n.9. However, states may not decide that "a contract is fair enough to enforce all its basic terms . . . but not fair enough to enforce its arbitration clause" because "that kind of policy would place arbitration clauses on an unequal 'footing,' directly contrary to the Act's language and Congress' intent. *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265, 281 (1995).

While the FAA permits states to reject arbitration agreements on "grounds as exist at law or in equity for the revocation of any contract," 9 U.S.C. § 2, the rule to determine unconscionability as applied in this case does not exist for "any" contract under California law but, rather, only for arbitration agreements that provide for individual and not class arbitration, in cases involving claims

which the California courts designate as being "modest" in amount, and where the court views class litigation as a means to deter fraudulent conduct. This rule does not treat arbitration provisions in this class like any other contract; rather, it subjects them to special scrutiny expressly prohibited under the FAA.

This Court has often admonished that arbitration agreements must be enforced according to their terms. This Court has previously recognized that an arbitration clause may be enforced "even if the arbitration could not go forward as a class action." *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 32 (1991). The plurality of this Court also held in *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444 (2003), that where the parties' arbitration agreement was "silent" as to whether the parties consent to class arbitration, an arbitrator must decide that issue.

In a recent decision, *Stolt-Nielsen, S.A. v. Animal Feeds Int'l Corp.*, 130 S. Ct. 1758 (2010), this Court held that, under the terms of the parties' agreement, arbitration could not be ordered on a class basis because "a party may not be compelled under the FAA to submit to class arbitration unless there is a contractual basis for concluding that the party *agreed* to do so." *Id.* at 1775 (emphasis in original). This Court found that class arbitration could not be compelled because the parties had "reached 'no agreement' on that issue." *Id.* In reaching this decision, this Court restated the

fundamental principle under the FAA that parties are "'free to structure their arbitration agreement as they see fit.'" *Id.* at 1763.

California's rule permits the courts to effectively ignore the parties' agreement and place their own policy preference for class litigation above the federal policy of ensuring the enforcement of arbitration agreements as written. *See, e.g., Stolt-Nielsen, supra.*; *Mastruobuono*, 514 U.S. at 53-54 (1995); *Volt*, 489 U.S. at 479.

Equally concerning is that the *Discover Bank* rule invites courts to draw arbitrary lines between claims that are large enough to warrant individual arbitration and claims that are too modest in amount to justify it. That rule enables the courts to pre-judge the merits of the plaintiff's allegations to determine whether the litigant plead fraudulent conduct on the part of the defendant which was designed to cheat a large number of consumers out of small amounts of money. This consideration of the underlying claims is not the type of inquiry which courts should be conducting when asked to determine the enforceability of the parties' arbitration agreement under the FAA. *See Allied-Bruce*, 513 U.S. at 282 (1995) (O'Connor, J., concurring) (courts should avoid interpreting FAA in a way that would "foster pre-arbitration litigation that would frustrate the very purpose of the statute").

Even if California did have an across-the-board, broad-based rule that the presence of a class

waiver is grounds for revoking "any" contract containing it, such a rule would nonetheless "stand[] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Fid. Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) and, therefore, would be preempted under the FAA. *See Geier v. Am. Honda Motor Co.*, 529 U.S. 861, 869- 874 (2000).

This Court recognized long ago the superior "simplicity, informality, and expedition of arbitration." *Mitsubishi*, 473 U.S. at 628. "[T]he fact that certain litigation devices may not be available in an arbitration is part and parcel of arbitration's ability to offer 'simplicity, informality, and expedition,' characteristics that generally make arbitration an attractive vehicle for the resolution of low-value claims." *Iberia Credit Bureau, Inc. v. Cingular Wireless, LLC*, 379 F.3d 159, 174 (5th Cir. 2004) (quoting *Gilmer*, 500 U.S. at 31).

The fact that class actions may be appropriate in some situations should not force parties to choose between conducting arbitrations on a class-wide basis or losing the right to arbitrate at all as California courts have held. That result undermines entirely the reasons arbitration is favored and, therefore, "frustrate[s] the purpose" (*Livadas v. Bradshaw*, 512 U.S. 107, 116 (1994)) of the FAA.

II. THE COURT SHOULD GRANT CERTIORARI AND, IN THE INTEREST OF JUDICIAL ECONOMY, HOLD THIS CASE PENDING ITS DECISION IN *AT&T v. CONCEPCION*.

The similarities between the instant case and *AT&T v. Concepcion* are striking. Like the Ninth Circuit decision in *AT&T* (*Laster v. AT&T Mobility LLC*, 584 F.3d 849 (9th Cir. 2009), the Court of Appeal decision in this case found the class action waiver to be unconscionable, not because it precluded the plaintiffs from vindicating their *own* claims, but because it precluded them from serving as a class representative for the vindication of claims of third parties.[12]

Also like the Ninth Circuit's decision, the decision in this case requires that no consumer arbitration provision governed by California law is enforceable unless it allows for class-wide arbitration. Such a holding violates the Supremacy Clause (*see Pyburn*, *supra*, 63 S.W.3d at 365) and, as demonstrated *supra*, is preempted by the FAA.

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[12] The trial court found that the time and expense of arbitration would deter individual claims. Pet. App. 34A. Baillie, in contrast, was undeterred. The Court of Appeal likewise made no finding that Baillie would be unable to vindicate her rights in arbitration, and instead focused on the "vulnerable members of society" who allegedly were targeted, and noted that the question whether a class action is a significantly more effective practical means of vindicating unwaivable statutory rights "is not at issue here." Pet. App. 22A, 23A.

Like the Ninth Circuit's decision, application of the *Discover Bank* rule in this case is in direct conflict with the FAA and contrary to this Court's holdings that "arbitration is a matter of consent, not coercion," *Stolt-Nielsen*, 130 S. Ct. at 1775. Courts simply should not be rewriting the parties' agreement, or conditioning their enforcement based on a public policy preference for class action. In *Stolt-Nielsen*, this Court held that an arbitration agreement that does not expressly permit class arbitration is deemed to preclude it[13] and, therefore, the parties' agreement to proceed with arbitration could not be conditioned on doing so on a class basis. This Court stated:

> Whether enforcing an agreement to arbitrate or construing an arbitration clause, courts and arbitrators must "give effect to the contractual rights and expectations of the parties." . . . In this endeavor, "as with any other contract, the parties' intentions control."

Id. at 1773-74 (internal citations omitted). This Court further reiterated that:

> [A]rbitration is simply a matter of contract *between the parties*; it is a way

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[13] In *Stolt-Nielsen*, this Court explained that "the differences between bilateral and class-action arbitration are too great for arbitrators to presume, consistent with their limited powers under the FAA, that the parties' mere silence on the issue of class-action arbitration constitutes consent to resolve their disputes in class proceedings." *Id.* at 1776.

> to resolve those disputes – but only those disputes – that the *parties* have agreed to submit to arbitration.

Id. at 1774 (quoting *First Options*, 514 U.S. at 943 (emphasis added by Court)).

This Court emphasized that the courts must not lose sight of the purpose of the FAA: to "give effect to the contractual rights and expectations of the parties." *Id.* at 1774 (*quoting Volt*, 489 U.S. at 479). Like the Ninth Circuit case, the application of the *Discover Bank* rule defeats the purpose and significance of the FAA. Decisions such as this one implicitly suggests that arbitration agreements must explicitly *authorize* class arbitrations in order to be enforceable -- a result which clearly puts arbitration agreements on a different footing than any other agreement, in direct violation of Section 2 of the FAA, 9 U.S.C. § 2.[14]

Also similar to the Ninth Circuit holding, the courts in this case concluded that the inclusion of a ban on class actions is deemed to be "exculpatory" and, therefore, unconscionable under *Discover Bank*. The application of an exculpatory analysis to determine unconscionability focuses on the impact of the arbitration clause, and not whether the parties

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[14] As of now, the courts of California have held that an affirmative class action waiver is unconscionable. To be consistent, a "silent" arbitration agreement would also be unconscionable on the same basis, but such a holding would also be in conflict with the FAA.

can effectively vindicate their rights in arbitration, regardless of whether the parties agreed to pursue their claims on an individual or a class basis. The Court of Appeal viewed *Discover Bank* as being concerned more with deterring conduct that invites class action litigation, rather than enforcing the arbitration agreement according to the parties' agreed upon terms. Application of a policy favoring class actions to deter businesses from utilizing arbitration provisions in consumer contract involving small amounts does not constitute a ground "for the revocation of any contract" as required by § 2 of the FAA.

Equally important, like *AT&T v. Concepcion*, Petitioners in the instant case challenge the legitimacy of the *Discover Bank* test and the courts' ability to invoke substantive unconscionability to invalidate arbitration agreements on the basis of class action waivers contained in those provisions. Each of these issues is currently before this Court, and their resolution surely will guide courts in California and elsewhere.

Like the Ninth Circuit, the California state courts here erred in giving preference to California's public policy of conditioning the enforcement of arbitration agreements on the availability of class arbitration. This case raises the same questions now before this Court in *AT&T v. Concepcion*. The issue presented is of importance to the application of the FAA by the state courts and, in particular, those of California. Therefore, Petitioners request that their

petition be granted and held for decision pending this Court's decision in *AT&T v. Concepcion*.

CONCLUSION

Like AT&T, Petitioners seek to resolve a question which for over 20 years has left entities subject to the mercy of the state and federal courts which have applied public policy, rather than preemptive federal law, to determine the procedure by which parties may agree to arbitrate their claims. Petitioners respectfully request that certiorari be granted for review of the issue in this case, and held pending this Court's decision in *AT&T v. Concepcion*.

Respectfully submitted,

Susan Verbonitz,
Counsel of Record
Marc J. Zucker
Weir & Partners, LLP
Suite 500
The Widener Building
1339 Chestnut Street
Philadelphia, PA 19107
(215) 665-8181
sverbonitz@weirpartners.com

Counsel for Processing Solutions, LLC, First East, Inc. and Instant Cash USA, Inc.

APPENDIX A

Court of Appeal, First Appellate District,
Division Three – No. A125167

S184194
IN THE SUPREME COURT OF CALIFORNIA
En Banc

AMY LYNN BAILLIE,
Plaintiff and Respondent,

v.

PROCESSING SOLUTIONS, LLC et al.,
Defendants and Appellants.

The petition for review is denied.

George, C.J., was absent and did not participate.

SUPREME COURT
FILED
AUG 11 2010
Frederick K. Ohlich Clerk
Deputy

CORRIGAN

Acting Chief Justice

APPENDIX B

COURT OF APPEAL
FIRST APPELLATE DISTRICT
350 MCALLISTER STREET
SAN FRANCISCO, CA 94102
DIVISION 3

AMY LYNN BAILLIE,
Plaintiff and Respondent,
v.
PROCESSING SOLUTIONS et al.,
Defendants and Appellants

A125167
Alameda County No. RG07327031

BY THE COURT:

The petition for rehearing is denied.

Date: JUN 22 2010 McGuiness, P.J.

APPENDIX C

Filed 5/7/10

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

California Rules of Court, rule 8.1115(a), prohibits courts and parties from citing or relying on opinions not certified for publication or ordered published, except as specified by rule 8.1115(b). This opinion has not been certified for publication or ordered published for purposes of rule 8.1115.

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION THREE

AMY LYNN BAILLIE Plaintiff and Respondent, v. PROCESSING SOLUTIONS, LLC et al., Defendants and Appellants.	A125167 (Alameda County Super. Ct. No. RG 07-327031)

Defendants and appellants Processing Solutions, LLC et al. (defendants), appeal the trial court's order denying their motion for stay pending

arbitration. The trial court concluded defendants could not compel plaintiff and respondent Amy Lynn Baillie (plaintiff) to arbitrate her dispute because the arbitration agreement in the contract between the parties is unconscionable. Defendants contend: (1) the trial court was not empowered to decide the issue of the enforceability of the arbitration agreement and should have referred that matter to the arbitrator; (2) the arbitration agreement is not unconscionable; (3) even if the arbitration agreement is unconscionable in part, the trial court should have severed the unconscionable terms and sent the matter to arbitration. Finding appellants' contentions unpersuasive, we affirm.

BACKGROUND

Defendant Processing Solutions, LLC is a Delaware company that acts as a servicing company for defendant MTE Financial Services, doing business as Instant Cash USA (MTE). Processing Solutions assists MTE in marketing loans over the internet and processes loan applications submitted electronically to MTE online.

In early July 2006, plaintiff submitted an application via the internet for a short-term loan in the amount of $300 from MTE. The terms of the Loan Note and Disclosure (Note) issued to and accepted by plaintiff stated that the borrower was required to repay the $300 advanced plus a $90 finance charge in one single payment due on July 14, 2006, unless the loan was renewed. If the loan was

renewed, the borrower paid only the finance charge of $90 on July 14, 2006, and would accrue a new finance charge of $90. On the fifth renewal of the loan, and every renewal thereafter, the borrower had to pay the $90 finance charge and pay the loan down by $50, to continue until the loan was paid in full. The Note discloses that the annual percentage rate under the terms of the loan agreement is 1,216.667% and authorizes the lender to debit the borrower's bank account automatically in order to collect payments due under the Note. Additionally, the Note states that, "By electronically signing this Agreement, you acknowledge that you have read, understand, and agree to all of the terms and conditions of the Loan Note and Disclosure and the ACH Authorization. Plaintiff signed the Note electronically by typing "I agree" next to her name when she submitted the loan application on July 2, 2006.

The Note contains an "AGREEMENT TO ARBITRATE ALL DISPUTES," which states, "By signing below and to induce us, MTE Financial Services dba Instant Cash USA, to process your application for a loan, you and we agree that any and all claims, disputes or controversies that we or our servicers or agents have against you or that you have against us, . . . that arise out of your application for one or more loans, the Loan Agreements that govern your repayment obligations, the loan for which you are applying or any other loan we previously made or later make to you, this Agreement To Arbitrate All Disputes, collection of the loan or loans, or alleging

fraud or misrepresentation, whether under the common law or pursuant to federal or state statute or regulation, or otherwise, including disputes as to the matters subject to arbitration shall be resolved by binding individual (and not class) arbitration by and under the Code of Procedure of the National Arbitration Forum ("NAF") in effect at the time the claim is filed. THEREFORE, THE ARBITRATOR SHALL NOT CONDUCT CLASS ARBITRATION; THAT IS, THE ARBITRATOR SHALL NOT ALLOW YOU TO SERVE AS A REPRESENTATIVE, AS A PRIVATE ATTORNEY GENERAL, OR IN ANY OTHER REPRESENTATIVE CAPACITY FOR OTHERS IN THE ARBITRATION."

While the arbitration agreement does not specify the costs or fees associated with the process, it states that "[i]f you are unable to pay the costs of arbitration, your arbitration fees may be waived by the NAF." Also, the agreement provides that the cost of a "participatory hearing" will be borne by the lender for claims under $15,000 and shared equally by borrower and lender if the claim is more than $15,000 and less than $75,000. It further provides that the participatory hearing will be held at a location near the borrower's residence. The final provision in the arbitration agreement states in capital letters: "NOTICE: YOU AND WE WOULD HAVE HAD A RIGHT OR OPPORTUNITY TO LITIGATE DISPUTES THROUGH A COURT AND HAVE A JUDGE OR JURY DECIDE THE DISPUTES BUT HAVE AGREED INSTEAD TO RESOLVE DISPUTES THROUGH BINDING

ARBITRATION."

In addition to the arbitration agreement, the Note includes a provision entitled, "AGREEMENT NOT TO BRING OR JOIN OR PARTICIPATE IN CLASS ACTIONS," which states, "To the extent permitted by law, by signing below you agree that you will not bring, join or participate in any class action as to any claim, dispute or controversy you may have against us . . . . You agree to the entry of injunctive relief to stop such a lawsuit or remove you as a participant in the suit. You agree to pay the costs we incur, including our court costs and attorney's fees, in seeking such relief. This agreement is not a waiver of any of your rights and remedies to pursue a claim individually and not as a class action in binding arbitration as provided above. This agreement not to bring, join or participate in class action suits is an independent agreement and shall survive the closing, funding, repayment and/or default of the loan for which you are applying."

On August 13, 2007, plaintiff filed her second amended complaint (SAC), a putative class action, against Processing Solutions, MTE and others. In the SAC, plaintiff alleged that between July 14, 2006 and December 1, 2006, defendants automatically debited a total of $977 from her bank account and then transferred the Note to a debt collection agency reflecting an amount due of $430. As a representative party on behalf of others similarly situated, plaintiff asserted causes of action for Usury and Unconscionable Lending, Injunctive Relief and

Restitution pursuant to Business and Professions Code section 17200 et seq., Unjust Enrichment, and An Accounting.

On or about March 9, 2009, defendants filed a Notice of Motion and Motion for Stay Pending Arbitration. Plaintiff filed a memorandum of points and authorities in opposition on or about March 25, 2009. After issuing a tentative ruling, the trial court entertained oral argument on April 10, 2009. Following argument, the trial court confirmed its tentative ruling and filed its order denying defendants' motion to compel arbitration. In its order, the trial court concluded the court, and not an arbitrator, should decide the issue of whether the arbitration clause is valid. The trial court also analyzed the arbitration agreement under *Armendariz v. Foundation Health Psychcare Services, Inc.* (2000) 24 Cal.4th 83 *(Armendariz)* and concluded that although " 'the evidence of procedural unconscionability is limited, the evidence of substantive unconscionability is strong enough to tip the scale and render the arbitration provision unconscionable.' [citation omitted] In the absence of an enforceable arbitration provision, there is no basis to stay the case pending arbitration." Notice of Entry of the court's order denying defendants' motion to compel arbitration is dated April 15, 2009. Defendants filed a timely notice of appeal on May 7, 2009.[1]

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1 An order denying a motion to compel arbitration is appealable pursuant Code of Civil Procedure section 1294, subdivision (a).

DISCUSSION

A. The Trial Court Properly Decided Enforceability of the Arbitration Agreement

Defendants contend that the trial court should have referred the question of arbitrability to the arbitrator. On this point, defendants rely on "basic principles of arbitration" set forth in *Dream Theatre, Inc. v. Dream Theatre* (2004) 124 Cal.App.4th 547, *552 (Dream Theatre)* and several other California appellate decisions. In *Dream Theatre,* the appellate court addressed the question of whether the court or the arbitrator should decide which disputes were subject to arbitration. *(Id.* at pp. 552-553.) The court's analysis was guided by several principles governing the review of arbitration agreements, specifically, (1) " ' " arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit.' [Citation.]' (Citation)" and (2) "the question of arbitrability is for judicial determination 'unless the parties *clearly and unmistakably* provide otherwise.' (Citation.)" *(Dream Theatre, supra,* 124 Cal.App.4th at p. 552 [italics added].)

Applying these principles to the arbitration agreement at bar, defendants assert that plaintiff agreed to submit the question of unconscionability to arbitration, consistent with the language of the

arbitration agreement stating that "any and all claims, . . . *including disputes as to the matters subject to arbitration,* shall be resolved by binding individual (and not class) arbitration." According to defendants, this language clearly and unmistakably gives the arbitrator the authority to decide the issue of the enforceability of the arbitration agreement. We respectfully disagree. Even assuming that parties may legally contract to arbitrate the issue of whether an arbitration agreement is unconscionable, the contractual language relied upon by defendants does not warrant the conclusion that they did so here.[2]

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[2] We note in passing that it is unclear whether *Dream Theatre's* broad pronouncement, that the question of arbitrability is for judicial determination unless the parties clearly and unmistakably provide otherwise, includes fundamental questions of contract formation. (Cf. *Dream Theatre, supra,* 124 Cal.App.4th at pp. 552-553 with *Engalla v. Permanente Medical Group, Inc.* (1997) 15 Cal.4th 951, 972-973 [pursuant to the summary procedure set forth in [Code of Civil Procedure] sections 1281.2 and 1290.2 for resolving petitions to compel arbitration, the trial court must decide whether there was fraud in the inducement of the arbitration agreement] and *Rosenthal v. Great Western Fin. Securities Corp.* (1996) 14 Cal.4th 394, 402 [concluding that questions about the existence or validity of an arbitration agreement "are to be resolved by the trial court in the manner provided for the hearing and decision of motions (Code Civ. Proc., § 1290.2), either on the basis of affidavits or declarations or, in the exercise of the court's discretion where necessary to resolve material conflicts in the written evidence, upon live testimony"].) We need not resolve this issue here because the specific language relied upon by defendant does not constitute a provision which clearly and unmistakably grants the arbitrator the power to resolve fundamental issues of contract formation, (see discussion, *post).*

First, we note that, as stated in *First Options of Chicago, Inc. v. Kaplan* (1995) 514 U.S. *938 (Kaplan),* any doubt about whether the court or the arbitrator should decide matters of arbitrability should be resolved in favor of the court deciding the issue. *(Id.* at pp. 944-945 [stating that "the law treats . . . ambiguity about the question " '*who* (primarily) should decide arbitrability' " differently from the way it treats silence or ambiguity about the question '*whether* a particular merits-related dispute is . . . within the scope of a valid arbitration agreement' " because it reverses the usual presumption that doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration].) Next, we turn to the pertinent language in the arbitration agreement at issue, which states that "you and we agree that *any and all claims, disputes or controversies that we . . . have against you or that you have against us, ... including disputes as to the matters subject to arbitration,* shall be resolved by binding individual (and not class) arbitration." While the language of the agreement referencing "any and all claims, disputes and controversies" is broad, it nevertheless fails to establish an agreement between the parties to submit to the arbitrator the questions of whether the arbitration agreement is unconscionable. Moreover, the language referencing claims or disputes that "we . . . have against you or that you have against us" contemplates a dispute between the parties arising from the terms of their contract rather than an attempt to avoid the contract entirely. In other words, the language of the agreement before us does not reflect a clear and

unmistakable understanding that such fundamental matters of contract formation as unconscionability (Civil Code section 1670.5), mistake, duress, fraud or undue influence (Civil Code section 1689) would be subject to arbitration.

Our conclusion in this regard is supported by a recent decision by our colleagues in the Court of Appeal, Second District, in *Sanchez v. Western Pizza Enterprises, Inc.* (2009) 172 Cal.App.4th 154, 166 *(Sanchez).* In *Sanchez,* the arbitration agreement at issue provided that "the arbitrator will resolve 'any disputes over the interpretation or application of this Arbitration Agreement.' "The critical language relied upon in *Sanchez* is broader than the language in the arbitration agreement before us. Nevertheless, the *Sanchez* court rejected the claim that the issue of whether the arbitration agreement was unconscionable should be submitted to the arbitrator, ruling instead that this language "does not appear to encompass disputes concerning the enforceability of the arbitration agreement based on unconscionability, public policy or other grounds." *(Id.* at p. 166.) We conclude, just as the court in *Sanchez,* that the language of the arbitration agreement before us does not clearly and unmistakably provide that matters of contract formation would be decided by the arbitrator.

Moreover, important factual distinctions between this case and *Dream Theatre* lend further support for our conclusion that the principles of arbitration set forth in *Dream Theatre* do not control

here. *Dream Theatre* involved an arbitration agreement between the buyer and seller of an internet-based multimedia and entertainment company. The contract contained comprehensive dispute resolution provisions in which the parties "used broad language to express their agreement to avoid litigation as a means of dispute resolution." *(Dream Theatre,* 124 Cal.App.4th at p. 550.) Also, the contract identified "the parties' respective obligations to indemnify one another from any and all losses, including those arising from either party's breach of the Contract as well as those arising from third party claims." *(Ibid.)* Subsequent to the sale, buyers discovered that sellers' largest customer gave notice of termination of its contract with sellers some days before the sale of the company to buyers. Buyers served sellers with an indemnification notice claiming losses of about one million dollars as a result of sellers' failure to disclose the loss of its principal customer. Sellers filed a motion to determine the arbitrability of buyers' claim. The trial court ordered the claim was not arbitrable and stayed arbitration. Buyers appealed. *(Id.* at p. 551.)

Against this background, the appellate court in *Dream Theatre* applied the two basic principles of arbitration set forth above, and relied upon by defendants here, to guide its conclusion: The court stated that: "It is difficult to imagine how parties could state any more comprehensively than they did in the Contract the intent to avoid litigation at every step of the dispute resolution process. The Contract provides that if a contested claim is not settled

within the contractual deadline, then it must be submitted to binding arbitration in accordance with the AAA Commercial Arbitration Rules. These rules specify that the arbitrator will decide disputes over the scope of the arbitration agreement. We conclude that the parties' agreement to arbitrate according to this rule is clear and unmistakable evidence of the intent that the arbitrator will decide whether a Contested Claim is arbitrable." *(Dream Theatre,* 124 Cal.App.4th at p. 557.) In *Dream Theatre,* therefore, the parties' express desire to avoid litigation as a means of resolving any disputes arising from their contract, the fact that the contract contained mutual obligations to indemnify the other from any losses arising from breach of the contract, and the provision that a contested claim not settled within the contractual deadline must be submitted to binding arbitration, all made it manifestly clear that the parties had agreed to submit any claim for indemnity under the contract to arbitration.

By contrast, the dispute here is not one arising from a provision in the contract (like the dispute arising from the indemnification provision in *Dream Theatre)* which the parties' arbitration agreement specifies must be decided by the arbitrator. Indeed, the dispute here does not arise out of the terms of the Note at all: Rather, it concerns a foundational issue of contract formation — is the arbitration agreement itself unconscionable?—and whether the court or the arbitrator resolves that issue. The arbitration agreement here simply does not address disputes over contractual formation issues in a manner that

would support a finding that the parties "clearly and unmistakably" agreed to submit disputes of this nature to the arbitrator for resolution. *(Dream Theatre, supra,* 124 Cal.App.4th at p. 552 [stating that "the question of arbitrability is for *judicial determination* 'unless the parties clearly and unmistakably provide otherwise.' (Citation)" [italics added]].)

In sum, for all the reasons discussed above, the principles of arbitration that were dispositive in *Dream Theatre* do not control here.[3] Thus, in light of the presumption that any doubt about whether the court or the arbitrator should decide matters of arbitrability should be resolved in favor of the court deciding the issue (see *Kaplan, supra,* 514 U.S. at pp. 944-945), we conclude that the trial court did not err

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[3] Other courts have distinguished *Dream Theatre* on the basis it involved an arbitration agreement freely negotiated between two sophisticated business parties and therefore did not involve a contract of adhesion: Those courts held that language in the parties' arbitration agreement which "clearly and unmistakably" allowed the arbitrator to decide the validity of the agreement was not dispositive where the contract was one of adhesion. (See *Murphy v. Check `N Go of California, Inc.* (2007) 156 Cal.App.4th 138, 144 *(Murphy)* [language in arbitration agreement allowing arbitrator to decide issue of unconscionabilty "could not be clearer, . . . [but] was vitiated by the fact that it was set forth in a contract of adhesion"]; *Ontiveros v. DHL Express (USA), Inc.* (2008) 164 Cal.App.4th 494, 504-505 [agreeing with analysis in *Murphy, supra,* and finding that provision in an arbitration agreement embedded in a contract of adhesion "giving the arbitrator exclusive authority to decide enforceability issues is unconscionable and, therefore, unenforceable"].)

by concluding it should decide the issue of whether the arbitration agreement is unconscionable.

B. The Arbitration Agreement Is Unconscionable

On appeal from the denial of a motion to compel arbitration, "[u]nconscionability findings are reviewed de novo if they are based on declarations that raise 'no meaningful factual disputes.' [Citation.] However, where an unconscionability determination `is based upon the trial court's resolution of conflicts in the evidence, or on the factual inferences which may be drawn therefrom, we consider the evidence in the light most favorable to the court's determination and review those aspects of the determination for substantial evidence.' [Citation.]" *(Murphy, supra,* 156 Cal.App.4th at p. 144.)

The basic legal framework for assessing unconscionability is well established. "'[U]nconscionability has generally been recognized to include an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party.' [Citation.] Phrased another way, unconscionability has both a 'procedural' and a 'substantive' element." *(A & M Produce Co. v. FMC Corp.* (1982) 135 Cal.App.3d 473, 486.) " 'The procedural element requires oppression or surprise. [Citation.] Oppression occurs where a contract involves lack of negotiation and meaningful choice, surprise where

the allegedly unconscionable provision is hidden within a prolix printed form. [Citation.] The substantive element concerns whether a contractual provision reallocates risks in an objectively unreasonable or unexpected manner.' [Citation.] Under this approach, both the procedural and substantive elements must be met before a contract or term will be deemed unconscionable. Both, however, need not be present to the same degree. A sliding scale is applied so that `the more substantively oppressive the contract term, the less evidence of procedural unconscionability is required to come to the conclusion that the term is unenforceable, and vice versa.' " *(Morris v. Redwood Empire Bancorp* (2005) 128 Cal.App.4th 1305, 1317, quoting *Armendariz, supra,* 24 Cal.4th at p. 114.)

1. Procedural Unconscionability

"The procedural element of an unconscionable contract generally takes the form of a contract of adhesion, ' "which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it." [Citation.]' " *(Little v. Auto Stiegler, Inc.* (2003) 29 Cal.4th 1064, 1071 [noting that in the case of pre-employment arbitration contracts was adhesive because "the arbitration agreement stands between the employee and necessary employment, and few employees are in a position to refuse a job because of an arbitration requirement"]; see also *Gentry v. Superior Court* (2007) 42 Cal.4th 443, 469 *(Gentry)* [noting that

whereas contracts of adhesion "are indispensible facts of modem life that are generally enforced (citation), [they] contain a degree of procedural unconscionability even without any notable surprises, and `bear within them the clear danger of oppression and overreaching.' (Citations.)"].)

As our Supreme Court has recently stated, an element of procedural unconscionability is normally inherent in a contract of adhesion where the party with inferior bargaining power is presented with the contract on a "take-it-or-leave-it" basis. (See *Discover Bank, supra,* 36 Cal.4th at p. 160 [element of procedural unconscionability present where "consumer is given an amendment to its cardholder agreement in the form of a 'bill stuffer' that he would be deemed to accept if he did not close his account]; *Szetela v. Discover Bank* (2002) 97 Cal.App.4th 1094, 1100 ["When the weaker party is presented the clause and told to 'take it or leave it'. without the opportunity for meaningful negotiation, oppression, and therefore procedural unconscionability, are present]; *Murphy, supra,* 156 Cal.App.4th at p. 144-145 [where plaintiff thought she was required to sign dispute resolution agreement as a condition of continued employment, substantial evidence supported the trial court's determination that the agreement was a contract of adhesion, and thus procedurally unconscionable].)

Similarly, in this case the arbitration agreement and the class action waiver were embedded in a contract of adhesion drafted by

defendants, the party of superior bargaining strength, and plaintiff was faced with the choice of either accepting those terms or foregoing the loan. The loan application gave plaintiff no ability to opt out of the arbitration agreement or to otherwise reject any of the particular terms in the contract. If plaintiff wanted the loan, she had to agree to the arbitration clause. Under these circumstances, we conclude that the trial court did not err in finding an element of procedural unconscionability in the arbitration agreement.[4]

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[4] We emphasize that in reaching this conclusion, we considered the fact that the arbitration agreement is embedded within a contract of adhesion for purposes of assessing whether the arbitration agreement is unconscionable: Whether the Note as a whole is unconscionable is an entirely separate issue that was not before the trial court and is not before us now on appeal. Thus, our conclusion today does not violate the holding in *Buckeye Check Cashing, Inc. v. Cardegna* (2006) 546 U.S. 440, 449 [holding that "a challenge to the validity of the contract as a whole, and not specifically to the arbitration clause, must go to the arbitrator"].)

2. Substantive Unconscionability

"[C]lass action waivers found in [] contracts [of adhesion] may also be substantively unconscionable inasmuch as they may operate effectively as exculpatory contract clauses that are contrary to public policy. . . . [¶] Class action . . . waivers are not, in the abstract, exculpatory clauses. But because . . . damages in consumer cases are often small and because ' "[a] company which wrongfully exacts a dollar from each of millions of customers will reap a handsome profit" ' (citation), ' "the class action is often the only effective way to halt and redress such exploitation." ' (Citation.) Moreover, such class action or arbitration waivers are indisputably one-sided. 'Although styled as a mutual prohibition on representative or class actions, it is difficult to envision the circumstances under which the provision might negatively impact Discover [Bank], because credit card companies typically do not sue their customers in class action lawsuits.' (Citation.) Such one-sided, exculpatory contracts in a contract of adhesion, at least to the extent they operate to insulate a party from liability that otherwise would be imposed under California law, are generally unconscionable." *(Discover Bank, supra,* 36 Cal.4th at p. 161.)

While the court in *Discover Bank* stopped short of holding that all class action waivers in consumer contracts are unconscionable, the court concluded that "when the waiver is found in a consumer contract of adhesion in a setting in which

disputes between the contracting parties predictably involve small amounts of damages, and when it is alleged that the party with the superior bargaining power has carried out a scheme to deliberately cheat large numbers of consumers out of individually small sums of money, then, at least to the extent the obligation at issue is governed by California law, the waiver becomes in practice the exemption of the party 'from responsibility for [its] own fraud, or willful injury to the person or property of another.' (Civ. Code, § 1668.) Under these circumstances, such waivers are unconscionable under California law and should not be enforced."[5] *(Discover Bank, supra,* 36

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[5] Asserting that MTE stands for "Modoc Tribal Enterprises, Inc." and that MTE is located on tribal land in Oklahoma, defendants suggest the trial court failed to consider adequately the question of whether Modoc Tribal Law should apply to the issue of unconscionability. In this regard, defendants make sweeping generalizations such as "Indian tribes have the power to make their own laws and to enforce those laws in their own forum" and "Tribal laws must be recognized by the courts." However, leaving aside any notice considerations (i.e. whether the Note properly disclosed that tribal law applied), defendants fail to show how the application of Modoc Tribal Law on the issue of unconscionability would pose any conflict with California law. Assuming arguendo that such a conflict exists, we agree with the trial court that California has a "materially greater interest than the chosen state in the determination of the particular issue." (See *Klussman v. Cross Country Bank (2005)* 134 Cal.App.4th 1283, 1291, [holding that "the fundamental nature of California's concern with protecting consumers" outweighs Delaware's interest in "uniform regulation of business practices of banks incorporated under its laws," therefore California law of unconscionability applies to class action waiver in credit card agreement, *id.* at p. 1300].)

Cal.4th at p. 162-163.)

The class action waiver in this case has all the hallmarks of unconscionability described in *Discover Bank, supra.* As already noted, the class action waiver here is included in an arbitration agreement that is integral to and embedded within a contract of adhesion. The complaint here involves a dispute over the terms of a loan for the modest sum of only $300. The complaint alleged that defendants, the party with the superior bargaining power, "specifically targeted the poorest and most members of society such as single parents, pensioners, persons on social assistance, the working poor, [and] the chronically underemployed" and "profited illegally" at the expense of these vulnerable members of society by charging usurious and unconscionable rates of interest. Under these circumstances, we conclude that the class action waiver in the arbitration agreement is unconscionable under the rationale of *Discover Bank, supra.*[6]

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[6] We reject defendants' assertion that *Gentry, supra,* requires a higher showing than the one made here before a court may find a class action waiver *in a consumer contract* unconscionable. Rather, the court held that in the context of deciding if a class arbitration waiver in an *employment agreement* violates public policy, the trial court should conduct an enquiry, "similar to the one it already makes to determine whether class actions are appropriate" *(Gentry, supra,* 42 Cal.4th at p. 463), in order to assess whether, in the "particular case, class arbitration would be a significantly more effective means than individual arbitration actions" to vindicate the statutory rights of the affected group of employees, *(id* at p. 466). The inquiry referenced in Gentry is different from that

C. Severance.

Defendant contends that even if the class action waiver is deemed unconscionable, the rest of the arbitration agreement is fair and mutual. Thus, according to defendant, the class action waiver should be severed and balance of the arbitration agreement enforced.[7]

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undertaken in *Discover Bank*, where the Supreme Court was concerned with consumer contracts under which companies are alleged to have "cheat[ed] large numbers of consumers out of individually small amounts of money" and seek to avoid the consequences of their actions by means of class action waivers. *(Discover Bank, supra,* 36 Cal.4th at p. 163.) In short, defendants' assertion conflates two separate and distinct legal theories under which courts may invalidate a class action waiver—as we do here under *Discover Bank* on the grounds that such a waiver is unconscionable, or under *Gentry* because a class action is a significantly more effective practical means of vindicating unwaivable statutory rights, which is not at issue here.

[7] The record shows defendants raised the severability issue below. At the close of oral argument, the trial court stated, "All right. Then the court will as indicated confirm its tentative ruling. And I'll have to review the text to make sure that the severability issue is addressed." However, the order subsequently issued by the trial court and now appealed by defendants did not address the issue of severability. Defendants did not move for reconsideration or otherwise bring this omission to the trial court's attention. Under these circumstances, we infer that the trial court found that severance was inappropriate and will sustain that finding if it is supported by substantial evidence. (See *Shaw v. County of Santa Cruz* (2008) 170 Cal.App.4th 229, 269 ["A failure to request a statement of decision results in a waiver of findings

The decision whether to sever or restrict an unconscionable provision in an arbitration agreement is one that falls with a trial court's exercise of "reasonable discretion." *(Harper v. Ultimo* (2003) 113 Cal.App.4th 1402, 1411; see also *Armendariz, supra,* 24 Cal.4th at p. 122 (noting that the unconscionability statute [Civil Code, § 1670.5] "appears to give the trial court some discretion as to whether to sever or restrict the unconscionable provision"].) In this regard, "[t]he overarching inquiry is whether ' "the interests of justice [] would be furthered' " by severance. (Citation)" *(Armendariz, supra,* 24 Cal.4th at p. 124.) Here, we cannot say that the trial court's refusal to sever the unconscionable term was an abuse of its reasonable discretion.

In *Armendariz,* our Supreme Court set forth the basic principles of severability applicable to the doctrine of unconscionability as follows: "If the central purpose of the contract is tainted with illegality, then the contract as a whole cannot be enforced. If the illegality is collateral to the main purpose of the contract, and the illegal provision can be extirpated from the contract by means of

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and conclusions necessary to support the judgment and we will accordingly infer such conclusions."]; and *SFPP v. Burlington Northern & Santa Fe Ry. Co.* (2004) 121 Cal.App.4th 452, 462 [under doctrine of implie findings, a party must object to any deficiencies in the trial court's statement of decision otherwise "the appellate court will imply findings to support the judgment" where supported by substantial evidence].)

severance or restriction, then such severance and restriction are appropriate." *(Armendariz, supra,* 24 Cal.4th at p. 124.) However, where a court cannot cure an unconscionable contract through severance or restriction, the court "is not permitted to cure it through reformation and augmentation, [but] must void the entire agreement. (Citation)" *(Id.* at p. 125.) The court applied these principles to an arbitration agreement that was unconscionable on two grounds,. namely, the limitations placed on the employee's rights to damages and the lack of mutuality ("because it requires only the arbitration of employee—but not employer—claims arising out of a wrongful termination"). *(Id.* at p. 120.) The court concluded the trial court "did not abuse its discretion in concluding that the arbitration agreement is permeated by an unlawful purpose" because the "multiple defects [in the arbitration agreement] indicate a systematic effort to impose arbitration on an employee not simply as an alternative to litigation, but as an inferior forum that works to the employer's advantage." *(Id.* p. 124.)

The arbitration agreement at issue here, like the one in *Armendariz,* is tainted with illegality. As we have already discussed, the class action waiver provision is unconscionable as contrary to public policy. *(Discover Bank, supra,* 36 Cal.4th at p. 162-163.) Also troubling is the provision in the arbitration agreement stating that disputes shall be governed by "the Code of Procedure of the National Arbitration Forum ("NAF") in effect *at the time the claim is filed.*" However, the arbitration agreement

did not include the NAF rules, it merely listed a web address (but did not provide a link to that address) and a physical address where plaintiff could obtain a copy of the NAF rules. However, even if plaintiff obtained a copy of the NAF rules in that way, the rules could have changed by the time any dispute arose. Thus, this provision, as drafted, provided plaintiff with no real notice at the time it was executed of what rules were actually being incorporated into the agreement. Rather, the provision merely specified that whatever NAF rules were current when the dispute arose would be enforced. The court in *Harper v. Ultimo, supra,* found a similar provision oppressive because it "pegs both the scope and procedure of the arbitration to rules which might change". *(Harper v. Ultimo, supra, 113* Cal.App.4th at p. 1407.)

In sum, the multiple defects contained in the arbitration agreement "indicate a systematic effort to impose arbitration on [a borrower] not simply as an alternative to litigation, but as an inferior forum that works to the [lender's] advantage." *(Armendariz, supra,* 24 Cal.4th at p. 124.) Thus, we conclude that substantial evidence supports a finding by the trial court that severance is inappropriate in this case. (Cf. *id.* [declining a request to sever based on two unconscionable arbitration provisions]; *Murphy, supra, 156* Cal.App.4th at p. 149 [same]; *Sanchez, supra,* 172 Cal.App.4th at p. 179 [same].) Accordingly, the trial court did not abuse its discretion by denying defendants' motion to compel arbitration and to stay court proceedings. *(In re*

Daniel C.H. (1990) 220 Cal.App.3d 814, 839 [no abuse of discretion where substantial evidence supports the order].)

DISPOSITION

The trial court's order denying defendants' motion to stay court proceedings and compel arbitration is affirmed. Defendants and appellants Processing Solutions, LLC et al., shall bear costs of appeal.

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Jenkins, J.

We concur:

McGuiness, P. J

Siggins, J.

APPENDIX D

SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA
RENE C. DAVIDSON
ALAMEDA COUNTY COURTHOUSE

Baillie Plaintiff/Petitioner(s) vs. Dollar Financial Corp. Defendant/Respondent(s) (Abbreviated Title)	No. RG07327031 Order Motion to Stay Proceedings Denied

The Motion to Stay Proceedings was set for hearing on 04/10/2009 at 10:00 AM in Department 20 before the Honorable Robert B. Freedman. The Tentative Ruling was published and was contested.

The matter was argued and submitted, and good cause appearing therefore,

IT IS HEREBY ORDERED THAT:

The tentative ruling is affirmed as follows: The Motion of Processing Solutions, First East, and Instant Cash USA to compel arbitration and to stay pending arbitration is DENIED.

ARBITRATION CLAUSE OVERVIEW.

MTE Financial Services loaned $300 to Plaintiff. Processing Solutions, First East, and Instant Cash USA are all alleged to be subsidiaries of or affiliated with MTE. The $300 loan is evidenced by a Note that contains an arbitration clause. The Note also contains a class action waiver in the arbitration clause, a separate class action waiver, and a choice of law provision stating that all applicable federal laws and the law in the lender's jurisdiction will apply.

NATURE OF THE MOTION.

Defendant's motion at issue is characterized as a motion to stay pending arbitration. There is no indication that arbitration is pending, so the Court construes the motion as a motion to compel arbitration and to stay pending the arbitration. "[Defendants] bear[] the burden of proving the existence of a valid arbitration agreement by the preponderance of the evidence, and a party opposing the petition bears the burden of proving by a preponderance of the evidence any fact necessary to its defense. ... In these summary proceedings, the trial court sits as a trier of fact, weighing all the affidavits, declarations, and other documentary evidence, as well as oral testimony received at the court's discretion, to reach a final determination." *Bruni v. Didion* (2008) 160 Cal.App.4th 1272, 1282. See also *Brown v. Wells Fargo Bank, NA* (2008) 168 Cal.App.4th 938, 952-953.

Pursuant to the Stipulation and order thereon filed and entered on March 17, 2009, the demurrer aspects of the motion will be heard at a later date. The Court suggests that hearing on the demurrer be reset for 4/24/09 at 11:00 am or the first date thereafter mutually available to the parties and the Court.

ROLE OF COURT AND ARBITRATOR.

Defendants assert that the arbitrator must decide whether the arbitration clause in enforceable. *Bruni v. Didion* (2008) 160 Cal.App.4th 1272, 1286-1287, states the applicable law: "Because the parties are the masters of their collective fate, they can agree to arbitrate almost any dispute-even a dispute over whether the underlying dispute is subject to arbitration. However, there is a presumption that they have not agreed to this. "The question whether the parties have submitted a particular dispute to arbitration, i.e., the 'question of arbitrability,' is 'an issue for judicial determination [u]nless the parties clearly and unmistakably provide otherwise.'"

The Note states that the arbitrator will decide all clams, disputes, or controversies "that arise out of your applicable for one or more loans." On the facts of this case, the parties did not "clearly and unmistakably" provide that the arbitrator will decide whether the Note is subject to arbitration. *Sanchez v. Western Pizza Enterprises, Inc.* (2009) 172 Cal.App.4th 154,***. Therefore, the usual process

applies and the court will decide whether there is a valid agreement to arbitrate between the parties. *Bruni* 160 Cal.App.4th at 1290. See also *Ontiveros v. DHL Exp. (USA), Inc.* (2008) 164 Cal.App.4th 494, 505-506 (contract of adhesion permitting arbitrator to decide issues related to the enforceability of arbitration clause is substantively unconscionable).

CHOICE OF LAW.

The Note states that all applicable federal laws and the law in the lender's jurisdiction will apply. Defendant assert that the Federal Arbitration Act applies. The Court finds a sufficient nexus to interstate commerce and that the FAA does apply. Under the FAA, the Court applies the same state law to contracts for arbitration as state law applies to other contracts. *Brown v. Wells Fargo Bank, NA* (2008) 168 Cal.App.4th 938, 954.

Defendants refer and rely on California law throughout their briefs. Only in the reply brief do Defendants suggest that the law of Oklahoma or of the Modoc tribe might apply to the issues before the Court. Reply at 6:9-7:20. The Court deems the choice of law issue waived as it concerns the arbitration issue. *In re Groundwater Cases* (2007) 154 Cal.App.4th 659, 693 ("Basic notions of fairness dictate that we decline to entertain arguments that a party has chosen to withhold until the filing of its reply brief, because this deprives the respondent of the opportunity to address them on appeal.").

Assuming that the choice of law issue had been presented, the Court would apply the analysis set out in *Klussman v. Cross Country Bank* (2005) 134 Cal.App.4th 1283, 1291-1292. There is a reasonable basis for choosing the law of the lender's jurisdiction. It is unclear whether law of the lender's jurisdiction is contrary to a fundamental policy of California, but assuming that such a conflict exists and favor the Defendants, California has a materially greater interest in the protection of California consumers. *Klussman*, supra.

ENFORCEABILITY OF ARBITRATION PROVISION

The Court presumes for purposes of this motion that the arbitration clause would cover the claims against the moving Defendants even though the moving Defendants are not parties to the Note.

Plaintiffs assert that the arbitration clause is not enforceable. The Court uses the analysis in *Armendariz v. Foundation Health Physicare Services, Inc.* (2000) 24 Cal.4th 83. Under *Armendariz*, unconscionability has procedural and substantive components. The two components operate on a sliding scale; the greater the procedural showing, the less is required from a substantive perspective, and vice versa. *Id.*, 24 Cal.4th at 114.

The arbitration clause has limited aspects of procedural unconscionability. The arbitration clause was reasonably disclosed in the Note. The Note was

a contract of adhesion and is therefore procedurally unconscioniable in some degree. *Gatton v. T-Mobile USA, Inc.* (2007) 152 Cal.App.4th 571, 585 ("use of a contract of adhesion establishes a minimal degree of procedural unconscionability notwithstanding the availability of market alternatives."). But see *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 160-161 (adhesive contracts are generally enforced).

The arbitration clause is substantively unconscionable. The arbitration clause expressly prohibits class arbitration. California has an interest in enforcing its laws against usury and improper debt collection activity. The drafters of the Note could have reasonably anticipated that claims would tend to be modest in amount and that the time and expense of filing a claim would deter individual claims. On the facts of this case, the Court finds that the claims are modest in amount and that the time and expense of filing a claim would deter individual claims. In addition, the reasonable inferences from the complaint are that the members of the putative class are not financially sophisticated and that they are not likely to be aware of their legal rights. Under these circumstances the enforcement of the arbitration clause and the included class arbitration waiver would act as a de facto exculpatory clause in violation of California law. *Gentry v. Superior Court* (2007) 42 Cal.4th 443, 457-463; *Discover Bank v. Superior Court* (2005) 36 Cal.4th 148, 160-163; *Sanchez v. Western Pizza Enterprises, Inc.* (2009) 172 Cal.App.4th 154.

The Court then applies the sliding scale test for unconscionability and reaches the same result as was reached in *Gatton v. T-Mobile USA, Inc.* (2007) 152 Cal.App.4th 571, 588 – "even though the evidence of procedural unconscionability is limited, the evidence of substantive unconscionability is strong enough to tip the scale and render the arbitration provision unconscionable." In the absence of an enforceable arbitration provision, there is no basis to stay the case pending arbitration.

Dated: 04/10/2009

Judge Robert B. Freedman